

Investment Management and Private Funds: What's Happening Now

Exotic fund structures and their implications, including AML and KYC

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March 22, 2018 | New York, NY

Securitization Vehicles

- ▶ Use of an SPV to convert unacceptable income/holding types to acceptable
 - blocker companies
 - wholly-owned CFC's for mutual funds to hold commodity futures
 - still need to make distributions to qualify for tax
 - life settlement trusts
 - payment dependent notes
 - swaps with subordination in a fund structure using an account control agreement
 - subordination is to prevent gearing

ISIN Structure

- ▶ Third party European issuer
- ▶ Irish Trust that has created the underlying legal structure for a given manager to be under as series xxxx of the trust
- ▶ Third party arranger/calculation agent that serves as fund administrator
- ▶ Named “qualified custodian” has custody of the product
- ▶ Publicly traded vehicle trades like a bond OTC in Euroclear/Euronext
- ▶ US RIA as portfolio manager of the vehicle (power of attorney to trade the funds of the trust, essentially like a management company in the case of a typical LP)
- ▶ PCAOB-firm as auditor

- ▶ Potential clients that want to participate do so via a Delivery Versus Payment transaction directly with the arranger and their own broker. Upon settlement, the money leaves the client's account at their brokerage and they in kind receive the shares of the ISIN. The funds are then placed by qualified custodian into the prime brokerage account for the Portfolio Manager to begin the investment management process.
- ▶ Each PM can create his/her own investment management guidelines via a PPM with a fee structure that works for them.
 - unique disclosure
 - unique fees
 - unique manager
- ▶ Costs??

- ▶ Tax issues – what is it
- ▶ Need to make sure not to run afoul of the interest expense limits imposed by the new Tax Act
- ▶ Who is the issuer
- ▶ Where do investors have redress?
- ▶ Withholding taxes?
- ▶ Private placement in the US under Reg D vs. international public offering under Reg S?
- ▶ 3(c)(1) for the sale into the US market?
- ▶ AML/KYC?

Who is Subject to AML Under US Law?

- ▶ The Bank Secrecy Act (BSA) applies to Financial institutions:
 - banks
 - broker or dealers in securities
 - money services businesses
 - futures commission merchants and introducing brokers in commodities
 - mutual funds
- ▶ Requirements promulgated by the Office of Foreign Assets Control (OFAC) apply to all US persons, regardless of whether the BSA applies.

Who Is Subject to AML Under US Law?

- ▶ **Mutual fund.** A “financial institution” under the BSA includes an “investment company” as defined in the Investment Company Act, which is an open-end company, as defined in the Investment Company Act, which is registered or is required to register with the SEC under the Investment Company Act.
 - A Mutual Fund is required to maintain a formal AML Program.
- ▶ **Investment Adviser.** “Any person who is registered or required to register with the SEC under section 203 of the Investment Advisers Act of 1940.” Such persons offer investment services and may sponsor or provide advisory services to mutual funds and advise clients on the purchase and sale of mutual fund shares or other products offered by insurance companies or broker dealers in securities.
 - An Investment Adviser is not required to maintain an AML Program.

New US AML Requirements for 2018

- ▶ **Effective May 11, 2018**, federally regulated banks and credit union, mutual funds, brokers or dealers in securities, future commission merchants, introducing brokers in commodities will be required to enhance their account opening due diligence and monitoring practices
- ▶ **Beneficial Owners.** For accounts opened on or after May 11, 2018, covered financial institutions will need to obtain and verify certain information on beneficial owners of legal entity customers. Such customers include persons who own or control at least 25% of the legal entity and include both corporate persons and certain executive officers.
- ▶ **Legal Entities.** Legal entities include a corporation, limited liability company, and other entities created by the filing of a public document with a Secretary of State or similar office, general partnerships (and similar entities created under foreign law), limited partnerships, and business trust. A legal entity does not include sole proprietorships, unincorporated associations, or natural persons acting for themselves.

What Law Governs Non-US Funds or Activities?

- ▶ **Financial Action Task Force on Money Laundering (FATF)**
 - An intergovernmental organization founded in 1989 on the initiative of the G7 to develop policies to combat money laundering. FATF has a strong global influence on AML requirements, including in the US. FATF expectations may exceed those of the US.
- ▶ **EU Anti-Money Laundering Directives** – EU member states are required to comply with AML Directives, which establish requirements for EU countries and exert a strong influence elsewhere, including in the US.
- ▶ **Financial Conduct Authority (FCA)** – Establishes and regulates the UK's anti-money laundering and counter terrorist financing (AML/CTF) regime.

What Requirements Apply to Bitcoin?

- ▶ Cayman Islands and Bermuda are sovereign countries each of which has its own respective AML laws, regulations, and supervisory expectations.
- ▶ Both Cayman Islands and Bermuda have expectations for the nature and form of verification of documentary evidence that are more rigorous than those of the US. For example, although Bermuda allows for the receipt of photocopied documents, the Guidance Notes require “verified copies” and provide direction regarding persons who would be able to serve as verifiers.
- ▶ Bermuda also has more rigorous requirements for beneficial ownership. For example, a corporate service provider with 10% ownership or control must be verified.
- ▶ The AML requirements of Cayman Islands extend to both mutual funds and persons who administer mutual funds.

What Requirements Apply to Bitcoin?

- ▶ In the US, the Financial Crimes Enforcement Network (FinCen) has issued informal guidance regarding whether and to what extent bitcoin and other virtual currencies are subject to AML requirements.
- ▶ In the EU, the Fourth Anti-Money Laundering Directive formally defines and regulates “virtual currency.”

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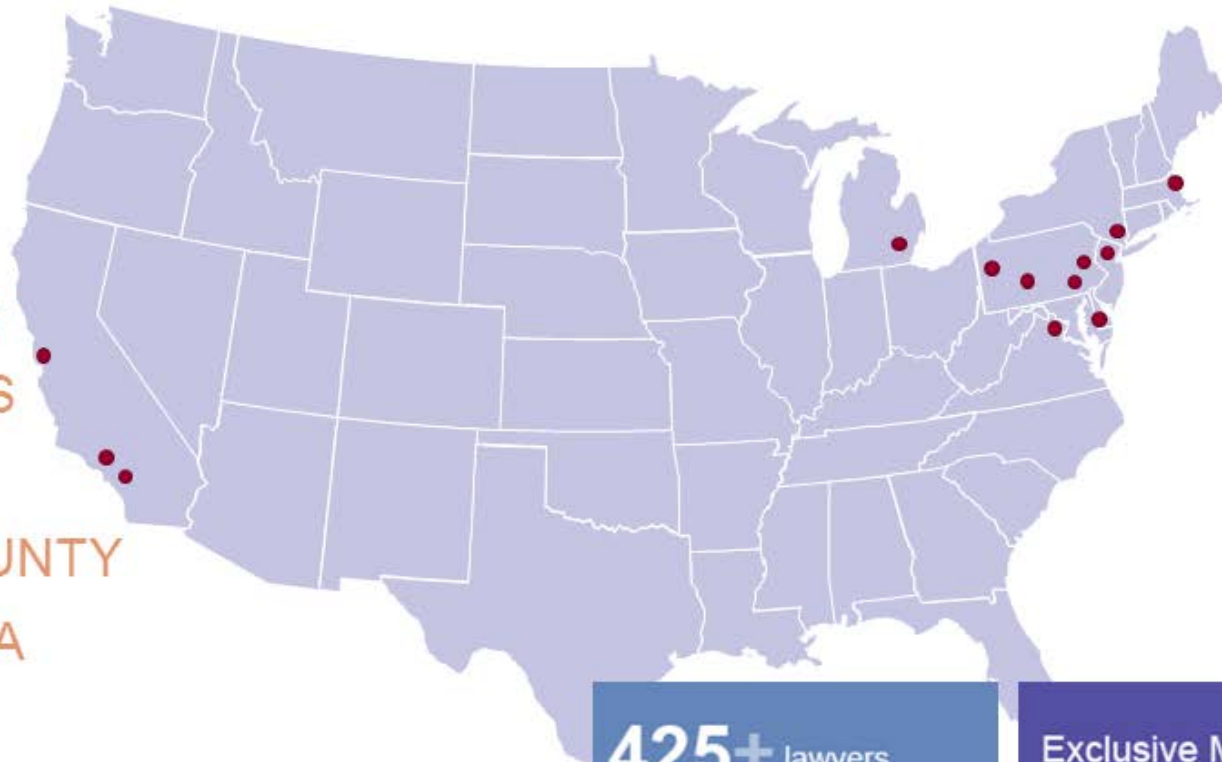
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- ▶ Concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940
- ▶ Represents many hedge funds and other alternative investment funds in fund formation and investment and compliance matters, including compliance audits and preparation work
- ▶ Writes and speaks frequently on issues involving investment management, health care and other matters. Mr. Nowak is the author of five books on hedge funds.



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- ▶ Seasoned financial professional with over 15 years of proven expertise in negotiating and marketing financial products, risk management, and both fixed income and equity securities transactions.
- ▶ Co-founder of Public Offering Corp which is the engine behind BANQ, the Electronic Trading and Financing Platform.
- ▶ Works with all aspects of transaction structuring for small private and public companies and specializes in distressed asset investing and capital markets introductions.



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- ▶ Extensive experience in consumer lending, safety and soundness, and anti-money laundering
- ▶ His work in consumer and regulatory compliance at large financial institutions has been marked by innovators that resulted in fundamental structural changes to existing firm-wide compliance activities, including with respect to regulatory change management, risk assessments, and vendor management.



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Chief Investment Officer, Red Ivy Capital

- ▶ Oversees all investment strategy, proprietary models, portfolio management, and trading.
- ▶ Prior to co-founding Red Ivy Capital, he was Head of Trading and Partner at SMB Capital, a proprietary trading firm in New York that features an elite training program.
- ▶ Has been trading equities, commodities and derivatives and developing his own models for the last 14 years, focusing on high frequency, short term strategies,
- ▶ Area of expertise features algorithmic trading, relative value, directional, and statistical arbitrage strategies.